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ISSUES & ANSWERS:

CAPTIVES AND DOMICILE SOLUTIONS

Industry experts discuss how to choose a captive manager and the role of actuaries in captive management.

Interviewed Inside:

Daniel Linton
Pinnacle Actuarial Resources

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Daniel Linton, Senior Consulting Actuary, Pinnacle Actuarial Resources, said that for a captive insurer, discussions regarding capital deployment strategy is the ideal time for the actuary, the captive manager, and the captive owner to engage in productive dialogue about opportunity—and risk. "The types of risks that keep you up at night," he said.

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Daniel Linton
Senior Consulting Actuary
Pinnacle Actuarial Resources

"When it's time to deploy capital, you want to make sure that you're leaving enough economic capital to support the operations of the captive to manage the risks that are already there."

Visit the Issues & Answers section at *www.bestreview.com* to watch an interview with Daniel Linton.

What is the actuary's role in the formation of a captive?

The actuary serves as a trusted adviser—playing a critical role in the formation phase of a captive. First, the actuary needs to be heavily involved in setting the overall structure of the captive—determining what coverages should be considered, as well as how much risk should be retained (i.e., risk tolerance). Ideally, this advisory relationship should be a dialogue between the actuary, the captive manager, and the captive owner to set a solid foundation for how the captive will operate in the coming years. In addition, the actuary will construct an actuarial analysis that will set rates and estimate the expected losses that will flow through the captive in the captive's first years of operation. Based on sound actuarial understanding of expected losses, the actuary can build a set of pro forma financial statements which will give stakeholders an understanding of the overall feasibility of the proposed structure.

Do reinsurance costs and available capital play into that decision?

Absolutely. It's a balancing act between reinsurance costs and how much capital the captive wants to hold. For example, rather than carry a $500,000 per occurrence limit, a captive owner chooses a $250,000 per occurrence limit. The result would be a lower capital requirement because the captive is taking on less risk. On the other hand, it increases your reinsurance costs because you're buying more reinsurance in the commercial market. It's a sophisticated balance that will vary from captive to captive based on risk tolerance.

What is the actuary's role as the captive grows up?

When the captive grows up, the actuary is going to serve two primary roles. The first is to review incurred claims and present an analysis of estimated outstanding losses (i.e., reserves). That gives captive management an opportunity to understand how actual claim development compares with projections derived from the previous actuarial report. Further these analyses give guidance to management on what they should book as reserves on the balance sheet. What follows is the actuary's review of the booked reserves and the issuance of the statement of actuarial opinion—a document that must be filed with the insurance department, or other regulatory body, where the captive is domiciled. Secondly, the actuary will set the expected losses for the upcoming policy period—similar to the exercise performed during the feasibility phase. During this time, the actuary, the captive owner, and the captive manager can discuss other opportunities available to the captive—whether it be introducing new coverages, expanding limits, etc.

How important is the actuary's relationship with the captive manager?

It's very important. I have found that the better the communication between the captive manager and actuary, the better the captive operates. It opens up the lines of communication, providing a conduit to respond to unexpected events quickly and efficiently. A sound relationship allows all parties, ideally including the actuary, captive manager and captive owner, to have meaningful discussions about the results of the actuarial report. That, in turn, provides all with key insights and hopefully agreement into how much capital is necessary to support the operations of the captive. Capital deployment should be an area of strategic opportunity for the captive and should be evaluated and planned for carefully.